STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 99-666

November 16, 2000

CENTRAL MAINE POWER COMPANY
Request for Approval of Alternative
Rate Plan (Post-Merger) "ARP2000"

ORDER APPROVING
STIPULATION

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. SUMMARY

By way of this Order we approve a Stipulation entered into between Central Maine Power Company (CMP) and the Office of the Public Advocate (OPA) and thus approve a new Alternative Rate Plan (ARP 2000) for CMP.[1] Under the terms of the Stipulation, ARP 2000 will be in effect for seven years, from January 1, 2001 through December 31, 2007.

Because generation service is now subject to market competition and is no longer regulated by this Commission, and the FERC has asserted jurisdiction over transmission service once a state unbundles generation from delivery service, ARP 2000 will only apply to distribution delivery rates and service. The Stipulation provides for annual rate changes to occur on July 1st of each year of the ARP. Rate changes are based on the now-familiar formula of inflation minus a productivity offset adjusted for mandated costs, earnings sharing and service quality penalties. The productivity offset in the first year of the Stipulation equals the rate of inflation. In 2002, the offset is set at 2.0%. The offset is adjusted upwards in subsequent years so that in the final year of the ARP, 2007, the offset reaches 2.9%.

We find that the parties supporting the Stipulation represent a sufficiently broad spectrum of interests to ensure that there has not been disenfranchisement and that the process that led to the Stipulation was fair to all parties. In addition, we find the stipulated result of the Stipulation is reasonable and consistent with both legislative mandate and the public interest.

II. INTRODUCTION AND BACKGROUND

A. Procedural History

See Appendix A.

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[1]Commissioner Diamond voted against this decision. See attached dissenting opinion.

B. Background to the Present Case

In December 1993, following a series of rate cases and rate increases, the last of which involved a review of CMP's management, the Commission concluded it should consider moving from traditional cost of service/rate of return regulation to a multi-year price cap approach. *Central Maine Power Company, Proposed Increase in Rates,* Docket No. 92-345, Order at 125 (Dec. 14, 1993). The Commission found that a multi-year cap plan would provide the following benefits: (1) electricity prices continue to be regulated in a comprehensible and predictable way; (2) rate predictability and stability are more likely; (3) regulatory "administration" costs can be reduced, thereby allowing for the conduct of other important regulatory activities operations; (4) risks can be shifted to shareholders and away from ratepayers (in a way that is manageable from the utility's financial perspective); and (5) because exceptional cost management can lead to enhanced profitability for shareholders, stronger incentives for cost minimization are created. *Id.* at 130. The Commission therefore initiated a follow-up proceeding to develop a price cap plan for CMP.

After nearly a year of litigation, the Commission approved a Stipulation which established a 5-year Alternative Rate Plan (ARP 95) for CMP. *Central Maine Power Company, Proposed Increase in Rates,* Docket No. 92-345 (Phase II), Detailed Opinion and Subsidiary Findings (Jan. 10, 1995). ARP 95 allowed CMP's rates to change based on changes to the rate of inflation, measured by the GDP-PI, less a productivity offset, and further adjusted for mandated costs, earnings sharing and service quality penalties.

During the course of ARP 95, the Legislature passed the Electric Industry Restructuring Act, 35-A M.R.S.A. § 3201 *et. seq.* which, effective March 1, 2000, deregulated generation services and provided Maine consumers with direct retail access to the generation market. Pursuant to the provisions of 35-A M.R.S.A. § 3208, the Commission initiated an investigation of CMP's Transmission and Distribution (T&D) revenue requirements, stranded costs and rate design. On February 24, 2000, we issued an order which set CMP's T&D rates effective March 1, 2000. *Public Utilities Commission, Investigation of Central Maine Power Company's Stranded Costs, Transmission and Distribution Utility Revenue Requirements and Rate Design,* Docket No. 97-580 (Phase II-B), Order Approving Stipulation (Feb. 24, 2000). In *Maine Public Utilities Commission, Investigation of Retail Electric Transmission Services and Jurisdictional Issues,* Docket No. 99-185, Order Approving Stipulation (Central Maine Power Company) August 28, 2000, we recognized that the Federal Energy Regulatory Commission (FERC) had asserted jurisdiction over transmission service once a state unbundled generation service from regulated retail service. Therefore, we unbundled transmission service costs from the T&D revenue requirement we had established in Docket No. 97-580 and established rates for distribution services only, including stranded costs.

On June 15, 1999, during the restructuring process, CMP announced that it had entered into a proposed merger agreement with Energy East Corporation (Energy

East). On September 30, 1999, CMP and Energy East submitted a proposal for a rate plan to succeed ARP 95, entitled "ARP 2000." In our order approving the proposed Energy East/CMP merger, we required, as a condition of approval, that Energy East and CMP keep their ARP 2000 proposal "on the table" for a period of two years. *CMP Group, Inc., et. al., Request for Approval of Reorganization and of Affiliated Interest Transactions,* Docket No. 99-411, Order (Jan. 4, 2000). This docket was initiated by way of a Notice of Proceeding issued on March 10, 2000.

C. <u>Proposals Before the Commission</u>

1. <u>CMP/Energy East</u>

In its September 30, 1999 filing, the Company proposed a 7-year rate plan which would adjust T&D rates annually for the following four items:

a. Inflation, less an enhanced Productivity Offset;
b. Mandated Costs;
c. Earnings Sharing; if any; and
d. Customer service penalties, if any.

The productivity offset for the 2001 price change would be 1%; for 2002, 1.25%; for 2003, 1.5%; and for 2004 through 2007, 1.75%. The Company's productivity recommendations were based on the Total Factor Productivity study conducted by its witness Dr. Jeffery Makholm adjusted upwards for a consumer dividend.

Mandated costs under the Company's plan would be defined as costs which have a disproportionate effect on the Company or the electric utility industry and are not adequately accounted for in the price index. Mandated costs would be allowed to the extent individual items exceed a $50,000 threshold and the aggregate annual amount exceeds $3 million. Only aggregate amounts in excess of $3 million would be included in rates. In addition, the Company proposed removing expiring annual amortizations associated with ice storm, deferred DSM and employee transition costs.

Earnings sharing on a 50/50 basis would occur where earnings were either 350 basis points above or 350 basis points below the 10.5% ROE target established by the Commission in Docket No. 97-580. Earnings sharing would be calculated on CMP's regulated financial earnings. The amortization of the merger acquisition premium would be excluded in calculating low-end earnings sharing. The unamortized balance of the acquisition premium would not be included in rate base in calculating the Company's return on equity.

The Company proposed that it be given significant rate design flexibility by being allowed to apportion the price change allowed by the index to specific rate elements within a class with the objective of moving the level of rate elements closer to costs. CMP would also retain pricing flexibility granted under ARP 95 and extended by the Commission in Docket No. 99-155 with the several revisions and the biggest change being that CMP could enter into 7-year contracts, which otherwise qualify for 30 day approval.

Finally, the Company proposed that the same reliability and service quality criteria, standards and penalties of ARP 95 be continued in the new ARP.[2]

2. OPA

In its direct case, the OPA proposed a 5-year rate plan. Through the joint testimony of Dr. Neil Talbot and Ron Norton, the OPA proposed a base productivity offset of 1.5%, based on Dr. Makholm's study adjusted to reflect an input price differential and a more recent time period. Talbot/Norton recommended that this base level offset then be adjusted for a stretch factor, which would start at .5% and would decrease by .1% annually during the plan. This base productivity offset would also be adjusted to reflect a merger dividend, which would start at .25%, and would increase annually by .25%.

The OPA recommended an earnings sharing mechanism similar to CMP's proposal. Under the OPA's proposal, however, the acquisition premium would be excluded from both the high-end and the low-end earnings calculation. The OPA also recommended that the Company's capital structure be monitored in conjunction with the Company's annual ARP filings.

The OPA proposed that the Commission continue to use the five service quality and customer service measures included in ARP 95, but proposed more stringent baseline levels for three of the five. Through its witness, Barbara Alexander, the OPA also proposed to add three additional measures: the speed at which CMP answers telephone calls to its business lines; the Lost Time Frequency measure set by the federal Occupational Safety and Health Administration; and CMP's compliance with the enrollment of Competitive Electricity Providers pursuant to Commission Rules. Ms. Alexander proposed an additional measure be developed for implementation in the third year of ARP 2000: a measure of momentary interruptions affecting CMP's power quality, MAIFI.

The OPA did not propose any changes to the method of excluding data resulting from major storms, or the way in which any penalties resulting from deteriorating service quality would be treated (revenue reductions reflected in annual price changes under the ARP). The OPA proposed to increase the penalty levels that would result from deteriorating service, and to increase the cap on total annual penalties from $3M in ARP 95 to $4.5M.

[2] The five ARP 95 measures were: Customer Average Interruption Duration Index (CAIDI), System Average Interruption Frequency Index (SAIFI), PUC Complaint Ratio, and customer surveys related to on-time installations and employee knowledge.

The OPA also proposed that annual reports to the Commission on ARP performance incorporate an attestation by a senior company officer, or independent verification of data. OPA Witness Alexander further proposed that CMP provide an annual "Report Card" to all customers reflecting its ARP performance for the prior year.

D. Bench Analysis

The Advisory Staff in its Bench Analysis also proposed a 5-year plan. Similar to the Company's plan, the Bench Analysis plan would only apply to distribution rates, and not to stranded cost charges.

The Bench Analysis recommended that the Commission adopt a 3% annual productivity offset. This offset was based on a 2.0% base productivity offset and a 1% stretch factor. The base productivity factor was based on Dr. Makholm's study adjusted to reflect a more current time period, an unweighted sample group and the removal of the input price differential as well as an alternative productivity analysis which looked at the changes in real distribution cost of service per kWh for 113 investor-owned utilities. The stretch factor was based on a regression analysis conducted by the Advisory Staff's consultant Ed Bodmer, which attempted to measure additional levels of productivity that could be expected of CMP based on the current levels of productivity compared to the industry average.

The Staff accepted many of the other proposals set forth in CMP's plan. The most notable differences between the Company's Plan and Bench Analysis proposal were Staff's recommendation that a more specific definition of mandated costs be adopted; that the expiring amortizations proposed for removal by CMP be taken out of rates at the time of their expiration during the rate year, and that rates be adjusted annually to reflect the declining rate base of these regulatory assets; that the low-end earnings sharing would occur only for earnings below 5.2%; and that high-end sharings be removed. The Staff also recommended that the Company's request for rate design flexibility in apportioning the indexed price changes be rejected and that a rate design case including rate unbundling be accomplished in a Commission proceeding in the near future.

In its Bench Analysis, the Advisory Staff proposed to continue two ARP 95 measures of CMP's service reliability (CAIDI and SAIFI), with calculation of the indices based on both system-wide and service area levels. The Advisory Staff proposed a more stringent baseline for the CAIDI measure, and proposed that both indices be tightened even further beginning the third ARP year. The Bench Analysis proposed to replace the ARP 95 customer survey measure of on-time installation performance with actual achieved data, and proposed to eliminate the ARP 95 employee knowledge survey measure. The Advisory Staff proposed to lower the PUC Complaint Ratio baseline from ARP 95 levels.[3] The Bench Analysis further proposed new measures of service reliability[4] and power quality[5] for system-wide and service area level implementation in 2003.

The Advisory Staff proposed two new measures of CMP's consumer service in its response time to customer business and outage calls, and proposed that CMP collect data to support a further consumer satisfaction measure of consumer complaints not resolved in the initial contact with CMP, to be implemented in July 2002. The Bench Analysis proposed a measure to monitor CMP's performance in enrolling Competitive Electricity Providers pursuant to Commission Rules.

The Bench Analysis proposed to revise the method by which CMP excludes data during major storms from measurement indices, and proposed comprehensive annual service reporting and monthly informational filings to the Commission and that the parties be provided an opportunity to file evidence or analysis to support a re-examination of service quality baselines or calculations in 2003.

III. DESCRIPTION OF THE STIPULATION

A. Rate Adjustment Provisions

The ARP 2000 rate cap plan would apply only to CMP's distribution revenue requirements. The plan would not apply to Maine jurisdictional stranded costs, which will periodically be adjusted in accordance with 35-A M.R.S.A. § 3208, or to transmission rates which are now subject to FERC jurisdiction. Based upon our decisions in Docket Nos. 97-580 and 99-185, the Stipulation establishes starting point core distribution rates which will be changed annually on July 1st of each year by a Price Index (PI) formula. The PI formula can be stated as follows:

> PI = Inflation index – productivity offset +/- (mandated costs +/- net capital gains and losses) +/- expiring amortizations + earnings sharing – any service quality penalties

Consistent with the proposals of the Company, the OPA and the Advisory Staff, inflation will be measured by changes in the Gross Domestic Product – Price Index (GDP-PI). The Productivity Offsets agreed to are as follows:

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[3]The ARP I level was 1.17 complaints per thousand customers, and the Advisory Staff proposed a level of 1.00 complaints per thousand customers for ARP 2000.

[4]System Average Interruption Duration Index, or SAIDI.

[5]Momentary Average Interruption Frequency Index, and Momentary Average Interruption Frequency Index by Event (MAIFI and $MAIFI_E$).

Year of Price Change	Productivity Offset
2001	Equal to Inflation
2002	2.00%
2003	2.25%
2004	2.75%
2005	2.75%
2006	2.75%
2007	2.90%

Mandated costs are defined by the Stipulation as costs beyond the Company's control, which are a result of either 1) *force majeure* events such as storms, floods or riots; or 2) changes in federal or state legislation, regulations, taxes or accounting changes. To be eligible for recovery each mandated cost item must exceed $150,000. Eligible mandated costs will be aggregated and will be included in rates only if the aggregate exceeded $3 million. Only the amount over $3 million will be included in rates. Capital gains and losses from the sale of operating properly will be flowed through to ratepayers to the extent any individual gain or loss incurred in a year exceeds $150,000 and, when netted against each other and any other mandated costs, the total gain or loss exceeds $150,000.

The price index in 2002 and 2003 will be reduced by 2.90% and 7.5% to reflect the reduction and termination of amortization expenses in March 2003 for ice storm, reconcilable DSM costs, 1999 deferred DSM costs and employee transition plans. The 2003 rate reduction also reflects the revenue requirement effect of the elimination of these items from rate base.

The earnings sharing provisions agreed to in the Stipulation are identical to those proposed in the Bench Analysis. Thus, there is no top-end earnings sharing and revenue deficiencies below a 5.2% Return on Equity (ROE) from the calendar year prior to the price change are to be shared 50/50 between shareholders and ratepayers. Return on equity will be calculated on a financial reporting basis. The common equity amount to be used for this calculation shall be the Company's beginning/ending average common equity balance, excluding amounts related to any unamortized acquisition premium included in the common equity amount. The common equity for this calculation, excluding any unamortized acquisition premium, shall be capped at 47% of total capital, which shall include common equity, preferred stock, short-term debt, long-term debt, and any current maturities or sinking fund requirements of debt and preferred stock.

The price index will be applied equally to all rate elements. The Company will retain flexibility to offer targeted rate discounts pursuant to criteria similar to that established in Docket No. 99-195.

B. Service Reliability and Customer Service

The Stipulation contains an automatic incentive mechanism related to CMP's service quality. The Stipulation establishes baseline performance levels for several measures of service, and provides for a reduction in CMP's earnings of up to $3.6 million if CMP's performance fails to meet those baselines. Service quality will begin to be measured on January 1, 2001 under the Stipulation, with any reduction in earnings resulting from service quality performance reflected in price changes on July 1 in the years 2002 through 2007. The Stipulation does not subject CMP to any penalties related to its performance in 2007.

The Stipulation initially establishes eight customer service and reliability measures, two of which address service reliability: Customer Average Interruption Duration Index (CAIDI) and System Average Interruption Frequency Index (SAIFI). Five measures address the services delivered to CMP's customers: the number of complaints received by the Commission's Consumer Assistance Division, the speed of answering business calls and outage calls, CMP's installation of new services by the date promised, and a customer survey of customers who called CMP's business line. The remaining measure addresses the speed of CMP's response to requests to enroll customers with Competitive Electricity Providers.

The Stipulation excludes from the two service reliability measures data during outages that affect more than 10% of the customers in any of CMP's 11 service areas. It also excludes from the business call answering measure data on days when more than 10% of customers in any of CMP's service areas are affected by outages.

The Stipulation provides an opportunity for any party to request the Commission to modify the initially stipulated service quality indices during 2003, with resulting modifications effective January 1, 2004. The Stipulation specifically targets two of the initial eight measures for replacement during that process: the customer survey and PUC Complaint Ratio. The Stipulation calls for the parties to work collaboratively with the Commission Staff to develop the replacement measure(s), and to develop a mechanism to ensure that customers who call CMP to report life-threatening emergencies receive information about how to report these situations to appropriate emergency responders.

The Stipulation requires bi-monthly reporting to the Commission by CMP on all service reliability and customer service measures, and requires CMP to file annual reports on specified elements related to service quality, including an Annual Reliability Improvement Report. The Stipulation further provides that CMP will distribute an annual "report card" on its service quality performance directly to all its customers on an annual basis beginning in August 2002.

IV. OPPOSITION TO THE STIPULATION

A. Objections of the IECG

In a letter to the Commission dated September 12, 2000, the IECG outlined four objections to the Stipulation:

- Term of the ARP;
- Lack of Top End Earnings Sharing;
- Effect of Lower End Earnings Sharing on Stranded Cost Recovery;
- Contract Unbundling[6]

At the hearing Dr. Silkman, on behalf of the IECG, testified that the presence of down-side sharing without up-side sharing was inherently unfair since it allowed the Company to receive additional increases in rates if sales or savings were less than expected but did not provide ratepayers with similar protection if the revenues and savings were better than expected. Dr. Silkman indicated that, although his client might disagree, he felt that the removal of down-side earnings sharing would address his concerns.

The second problem identified by Dr. Silkman was its lack of top-side earnings sharing to mitigate overall bill increases should prices in the unregulated generation market increase. Dr. Silkman stated that he did not believe that there was a tremendous amount of money in excess T&D earnings to mitigate such increases, but he believed the problem to a large extent would be one of perception if the T&D utility's earnings in the neighborhood of 20% or 22% at the same time customers' bills were dramatically increasing.

Dr. Silkman was also concerned about the methodology of how down-side earnings sharing would be calculated. Dr. Silkman noted that down-side earnings sharing is based on total regulated company earnings. The ARP, however, only applies to distribution delivery service. Therefore, if rates for transmission or stranded costs are reset by either the FERC or this Commission to reflect the Company's low-end earnings situation, there is a double recovery problem. In addition, the recovery of non-distribution costs under the guise of earnings sharing in distribution rates raises legal and jurisdictional questions.

Counsel for IECG, Donald Sipe, argued that while his witness believed that the problem with earnings sharing provision could be resolved by simply removing the low-end sharing provision and thus create a symmetrical arrangement, this was not his or his client's position. Mr. Sipe argued that it was his position that there was both a constitutional and legal right of ratepayers to just and reasonable rates which are tied to

[6]Based on the explanation given by the stipulating parties at the hearing on the intent of the contract unbundling provision contained in the pricing flexibility provisions of the Stipulation, the IECG withdrew this objection.

the Company's rate of return.[7] Mr. Sipe argued that under 35-A M.R.S.A. § 301 the Commission cannot let rates of return go to unreasonable levels; that this obligation cannot be taken away by the Stipulation; and that if the Commission does intend to exercise such discretion it should inform the parties of this fact at the outset of the ARP in the Commission's Order.

B. Objections of the IEPM

The Independent Energy Producers of Maine (IEPM) also opposed the Stipulation. In written objections filed on September 12, 2000, the IEPM presents three grounds for its opposition.

First, the IEPM argues that the Stipulation's earnings sharing provisions which allow CMP to retain all "up side" earnings, but requires ratepayers to share in any losses if CMP's return on equity falls below 5.2% is poor public policy, is unfair to ratepayers, is contrary to the state's energy policies and is potentially unlawful. Specifically, the IEPM argues that if the ratepayers must share in the bad times they should also share in the good. By allowing CMP to retain all earnings on the upside, the Stipulation gives the Company an opportunity to encourage electricity sales and discourage energy efficiency. The IEPM notes that if the Stipulation provision which prohibits parties from opposing review of rates based on excessive earnings is seen as applying to the Commission, then the provisions of 35-A M.R.S.A. § 301 which prohibit unjust and unreasonable rates would be violated.

Second, the IEPM argues that the Stipulation violates the Commission's CMP/Energy East merger Order which required that a reasonable portion of merger savings be flowed through to ratepayers before the Company was allowed to recover its acquisition premium. The IEPM notes in this regard that the productivity offsets which range from 2.0% to 2.9% are significantly less than the 5% savings predicted by Energy East in the merger case.

Finally, the IEPM argues that the 7-year ARP period is much too long, particularly given the provision which allows CMP to retain excessive earnings.

V. DECISION

A. Standard for Review

To accept a stipulation the Commission must find that:

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[7] Counsel for the IECG has not presented us with any authority or support of his constitutional argument. Absent this detail, we cannot, and do not address in Section V, *infra.*, the IECG's bald assertion of a constitutional violation.

1. the parties joining the stipulation represent a sufficiently broad spectrum of interests that the Commission can be sure that there is no appearance or reality of disenfranchisement;

2. the process that led to the stipulation was fair to all parties; and

3. the stipulated result is reasonable and is not contrary to legislative mandates.

See Central Maine Power Company, Proposed Increase in Rates, Docket No. 92-345(II), Detailed Opinion and Subsidiary Findings (Me. P.U.C. Jan. 10, 1995), and *Maine Public Service Company, Proposed Increase in Rates (Rate Design),* Docket No. 95-052, Order (Me. P.U.C. June 26, 1996). We have also recognized that we have an obligation to ensure that the overall stipulated result is in the public interest. *See Northern Utilities, Inc., Proposed Environmental Response Cost Recovery,* Docket No. 96-678, Order Approving Stipulation (Me. P.U.C. April 28, 1997). We find that the proposed Stipulation in this case meets all these criteria.

The Stipulation before us was entered between the Company and the OPA. In past cases, we have found that these two entities, representing often opposite views in the ratemaking process, constitute a sufficiently broad spectrum of interests to satisfy the first criteria. *See Public Utilities Commission, Investigation of Stranded Cost Recovery, Transmission and Distribution Utility Revenue Requirements and Rate Design of Bangor Hydro-Electric Company (Phase II),* Docket No. 97-596, Order at 6 (Feb. 29, 2000) and *Maine Public Utilities Commission, Investigation of Retail Electric Transmission Services and Jurisdictional Issues,* Docket No. 99-185, Order Approving Stipulation (Maine Public Service Company) at 3 (Aug. 11, 2000). In this case, we also note that our Advisory Staff was an active participant in the settlement process and has not indicated any objection to the Stipulation. We are, therefore, satisfied that a broad spectrum of interests are represented by the Stipulation.

We also find that the second criterion has been met in this case. Although both the IECG and the IEPM have substantive objections to the Stipulation, neither has suggested that the process that led up to the Stipulation was unfair. Our review of the procedural history in this case also indicates that all procedural safeguards were satisfied in this instance.

The IECG and the IEPM have objected to the Stipulation on the grounds that the Stipulation is unlawful and unfair. We address the issues raised by these objections below.

B. Lawfulness of the Stipulated Result

The ARP 2000 plan presented to us in the Stipulation does not contain an upper-end earnings sharing provision. The IECG and the IEPM argue that the Stipulation violates our obligation to ensure just and reasonable rates under § 301 since there is no cap on what the Company could earn under the stipulated rate plan. We conclude that the lack of an earnings sharing mechanism is not, in and of itself, dispositive of the question of whether the rates ultimately produced by a price cap plan will be just and reasonable.

Section 3195 of Title 35-A authorizes the Commission to adopt reasonable rate adjustment mechanisms to promote efficiency in transmission and distribution utility operations. The possible adjustment mechanisms include an adjustment based on indexed or forecasted costs and mechanism which provide positive or negative financial incentives for efficient operations. 35-A M.R.S.A. § 3195. Thus, the Legislature has specifically authorized the Commission to deviate from the cost of service/rate of return approach to regulation which has traditionally been employed in setting utility rates.

Many price cap plans attempt to address the issue of "overearnings," or earnings above the most recently allowed rate of return, through an upper-end earnings sharing provision. While earnings sharing provisions lessen "overearnings," they are not eliminated by such mechanisms. First, a utility may retain all "overearnings" to the extent such earnings are in the non-sharing or "dead-band" area. Second, even if overearnings exceed the dead-band, they are not eliminated but rather are reduced in proportion to the sharing ratio either agreed to or imposed by the regulator. It is possible then, depending on the circumstances, that a utility operating under a price cap plan with earnings sharing could have higher earnings and higher rates than a utility that has a plan without sharing but incorporates savings to ratepayers through a higher productivity offset.

In *Public Utilities Commission, Investigation into Regulatory Alternatives for the New England Telephone and Telegraph Company d/b/a NYNEX,* Docket No. 94-123 Order at 90 (May 15, 1995), we specifically held that an earnings sharing mechanism was not a necessary component to a utility price cap plan. In that case, we concluded that ratepayers would obtain a substantial benefit from the high productivity offsets we established as part of the basic price change formula and therefore, no consumer dividend in the way of an earnings sharing component was necessary. We find that to be the case here as well. The ARP 2000 plan incorporates productivity offsets substantially greater than those included in past rate plans we have approved or are aware of. *See* Section V.C., *infra.* Therefore, although ARP 2000 lacks an upper end earnings sharing mechanism, ratepayers will receive through its incorporation of high productivity offsets, substantial benefits during the course of the plan. We thus conclude that the plan, overall, is likely to produce rates that are just and reasonable.

The crux of the IECG's and the IEPM's arguments is that the Stipulation has the potential to produce unjust and unreasonable rates because rates and earnings are not linked. Were we to accept the IECG's and IEPM's arguments here, we could never approve a price cap plan since such plans by their very nature decouple rates from earnings. In approving CMP's first alternative rate plan, we noted:

> No one should interpret our adoption of the Stipulation as a willingness to abandon our central regulatory task of ensuring that CMP's customers receive adequate service at just and reasonable rates.

Docket No. 92-345 (Phase II) at 2. We reaffirm this commitment here. As discussed above, we find that given the high productivity offsets agreed to in the Stipulation, we believe that ARP 2000 will likely produce just and reasonable rates. The question of whether a rate plan will actually produce rates that are just and reasonable is largely one of circumstance, and the fact that a particular price cap plan does not contain an upper-end sharing mechanism does not, by itself, mean that the rate produced will be unjust and unreasonable.

The IEPM also argues that the Stipulation is contrary to state energy policy in that retention of upside earnings gives an incentive to CMP to encourage electricity sales and discourage efficiency. Here again, we believe the IEPM's arguments can be seen as applying to any price-cap plan and not just the plan presented in the Stipulation. Once again, we would note that the Legislature has specifically authorized price cap plans such as the one before us. In addition, we note that the Legislature has specifically stated how it wished to implement demand-side management programs after restructuring. 35-A M.R.S.A. § 3211. Nothing in the Stipulation would interfere with the operation of State-mandated energy conservation programs. The IEPM's objections on this basis are, therefore, rejected.

C. Fairness and Reasonableness of the Stipulated Result

As discussed above, the IEPM and the IECG have also criticized the fairness of the plan proposed by the Stipulation. The biggest criticism in this regard is the earnings sharing mechanism's provision for low-end but not high-end earnings sharing. The parties argue that this asymmetry is inherently unfair. The IECG also criticizes the low-end sharing mechanism's potential for over-recovery of under-earnings. The IEPM argues that the Stipulation does not adequately flow through merger savings as required by our Order in Docket No. 99-411 and that the 7-year term of the plan is too long.

In deciding whether the Stipulation is fair and consistent with the public interest, the entire Stipulation must be considered as a package. Whether we disagree with a particular stipulation provision or would have come up with a different rate plan were we deciding the case after litigation is not the question. The question is whether the particular proposal before us is reasonable and consistent with the public interest. *See* Docket No. 92-345 (Phase II), *supra.,* Order at 3. In deciding this question, the detriments which have been raised must be weighed against the benefits of the Stipulation. For the reasons set forth below, we find that the rate plan agreed to in the Stipulation, when looked at as whole, is fair, reasonable and in the public interest.

We find the most attractive feature of the proposed ARP 2000 to be its relatively high productivity offsets. The Company in this case proposed productivity offsets starting at 1.0% and increasing to 1.75%. The OPA's average overall productivity offset was 2.5%, and the Bench Analysis proposed a productivity offset of 3% per year. During the first year of the rate plan the productivity offset would equal the rate of inflation which, based on current measurements, is approximately 2.6%. In the second year the productivity offset would be set at 2.00% and then would grow during the plan until it reaches 2.9% in the last year of the plan. On a levelized basis, these productivity offsets are equivalent to an annual productivity offset of 2.53%. We note that the productivity offsets contained in the Stipulation are close to those proposed by the OPA and our Advisory Staff, and are significantly higher than the productivity offsets contained in CMP's first ARP (1.0%) and in the Rate Plan we adopted for Bangor Hydro-Electric Company in 1999 (1.2%). *See* Docket No. 92-345 (Phase II), *supra.* at 8, and *Bangor Hydro-Electric Company, Proposed Increase in Rates,* Docket No. 97-116, Order at 63. During the course of the ARP these productivity offsets will serve to decrease rates in "constant dollar" terms by 18.0%.

We also believe that ratepayers will benefit from the service quality and reliability criteria agreed to in the ARP 2000 plan. In our Order in Docket No. 99-411, we stated that:

> We also put CMP on notice that we expect to closely examine service quality standards in the ARP 2000 proceeding. Given the risks involved in this merger, we will likely strengthen the standards relative to those in the existing ARP. We note that the standards in NYSEG's current rate plan are considerably more stringent than CMP's, and we expect to consider whether moving to, or beyond, the NYSEG level would be appropriate. In this context, we would also examine appropriate penalties and sanctions for violating the service quality standards.

Docket No. 99-411, *supra.,* Order at 25. The Stipulation moves the ARP 95 CAIDI standard of 3.0 hours to 2.58 hours and the SAIFI standard of 2.0 interruptions per customer to 1.8 interruptions per customer. The Stipulation includes new standards for service installation, answering both business and outage calls and properly completing enrollments from competitive electricity providers. In addition, the Stipulation increases the maximum penalty level from the $3.0 million level contained in ARP 95 to $3.6 million, despite the fact that the Company's revenues have decreased by about one-third as a result of restructuring. The Stipulation also provides for a mid-period review of service quality issues to take place in 2003. We thus find that the service quality standards agreed to significantly strengthen the standards from those contained in ARP 95, moves CMP towards the New York State Electric and Gas Corporation (NYSEG) performance levels and helps to ensure that earnings during ARP 2000 are not enhanced by the utility's providing inadequate or unreliable service.

We find that the benefits of high productivity offsets and strengthened service quality standards outweigh the detriments alleged by the objecting parties. Specifically, we do not believe ratepayers are significantly harmed by the absence of top-end earnings sharing. While incentive regulation plans with earnings sharing provisions have been around for a number of years, the instances where ratepayers have actually received rate reductions as a result of such provisions are rare. In our decision which adopted an alternative rate plan for NYNEX, we recognized that an earnings sharing provision could weaken the incentives for efficient operations and could create a perverse incentive that encourages the utility to "manage" its earnings in an inappropriate manner. Docket No. 94-123, *supra.,* at 90.

We also believe that, given the scope of this ARP, the probability of extremely high earnings is small. Pursuant to its formula rate-setting procedures, FERC will reset transmission rates annually. Similarly, we will reset stranded cost rates periodically during the ARP. The first resetting of stranded costs is scheduled for March 1, 2002.[8] We believe also that any low-end earnings sharing "double-counting" problem (as referenced by Dr. Silkman) can be addressed in the stranded cost resetting process.

The IEPM's arguments concerning the requirements of our Order in Docket No. 99-411 are misplaced. In the Energy East/CMP merger order we held that Energy East would not, as a matter of law, be precluded from recovery of its merger acquisition premium. To recover the premium, however, as part of a future rate request, the savings must exceed the costs of the merger and Maine ratepayers must receive at least a reasonable portion of the merger savings. Docket No. 99-411, *supra.,* at 27. In the rate plan agreed to in the Stipulation, there is no provision for recovery of the acquisition premium. To the extent that the Company can exceed the savings assumed by the plan's productivity offsets, these amounts could be applied by Energy East to the recovery of the merger premium. In no instance, however, would rates be higher as a result of Energy East's recovery of the premium. In addition, as noted above, the productivity offsets are significantly higher than what we have imposed upon electric utilities in the past. We believe that level of productivity offsets of the Stipulation reasonably incorporate efficiencies that we would expect to occur from the Energy East/CMP merger.[9]

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[8]As part of the stranded cost recovery process, CMP has a continuing obligation to assure that the amount of stranded costs to be recovered from ratepayers is, to the greatest extent possible, minimized. 35-A M.R.S.A. § 3208(4).

[9]The IEPM has also argued that Energy East in the merger case pointed to a 5% level of savings as a result of the merger while the productivity offsets agreed to in the Stipulation are in the 2% range. The 5% level of savings cited by Energy East, however, refer to savings in the O&M cost category and not overall Company savings. The productivity offsets on the other hand apply to distribution delivery rates or in other words total Company costs for distribution delivery service.

We also disagree with the IEPM's argument that this ARP is too long. While CMP's initial ARP was five years, this does not constitute the upper bound for rate plan terms. We believe that a longer term can strengthen the incentives and provide for greater price stability and predictability. In addition, we note that in our order approving the Energy East/CMP merger we stated that it would be increasingly difficult over time to link cost savings to the merger and, therefore, to recover the acquisition premium. Docket No. 99-411, *supra.* at 20. Thus, to the extent that the IEPM is concerned about the recovery of the acquisition premium in rates, the longer term of the ARP here actually makes such an event less likely.

It is possible, were we to decide this case after full litigation, that we would have had ordered a rate plan with both high-end and low-end earnings sharing. It is also possible that we would have adopted productivity offsets more in line with those proposed by the Company than those agreed to in the Stipulation. Interestingly, when faced with this choice, the choice of a plan with the Company's proposed productivity offsets and high-end earnings sharing, or a plan with productivity offsets as agreed to in the Stipulation with no high-end earnings sharing, the IECG's witness, Dr. Silkman, testified that he would opt for the higher productivity offset with no earnings sharing option.

By establishing high productivity offsets in the ARP 2000 plan, the stipulating parties have assured that ratepayers will benefit from expected productivity improvements during the course of the plan. In exchange for these guaranteed savings, ratepayers have given up the possibility of earnings sharing. We think that this trade-off is reasonable and consistent with the public interest.

We are, therefore, satisfied that the Stipulation in this case meets all of our criteria for approval.

Accordingly, it is

O R D E R E D

1. That the September 7, 2000 Stipulation submitted to us by Central Maine Power Company and the Office of the Public Advocate (a copy of which is attached hereto) is approved;

2. That the provisions of the Stipulation which set forth the terms of the ARP 2000 rate plan are incorporated by reference into this Order.

Dated at Augusta, Maine, this 16th day of November, 2000.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR:	Welch Nugent
COMMISSIONER VOTING AGAINST:	Diamond

THIS DOCUMENT HAS BEEN DESIGNATED FOR PUBLICATION

Separate Opinion of Commissioner Stephen Diamond

I dissent from the Order approving the Stipulation between Central Maine Power Company (CMP) and the Office of the Public Advocate and approving a new Alternative Rate Plan (ARP 2000) for CMP. Under the Stipulation, ratepayers are required to share the consequences of significant earnings shortfalls but do not benefit if earnings exceed the return on equity established by the Commission. Absent a clear showing that ratepayers are receiving special benefits to compensate for this decoupling of risk and reward, which I do not believe has been made in this case, I cannot find the Stipulation to be in the public interest.

Let me emphasize that ARP 2000 has many positive features and that while my concern about the asymmetrical approach to earnings sharing causes me to dissent, I nonetheless commend those whose efforts led to the Stipulation. As a general proposition, incentive rate plans have served Maine's ratepayers well. Regarding ARP 2000 specifically, my colleagues in the majority are right to praise its higher productivity offsets and more stringent service quality standards. Indeed, were it not for my view that there is something fundamental about the link between risk and reward, I would be comfortable joining them in approving the Stipulation.

An axiom of public utility regulation is that the decisions of regulators should strike a fair balance between the interests of ratepayers and the interests of shareholders. A corollary to that axiom, at least in my view, is that that the party that stands to reap the rewards should bear the risks, and to the extent that the one is shared so should the other be.

Under traditional cost of service/rate of return regulation, utilities are constrained in what they can earn, except as a result of regulatory lag. The rationale for this limitation is that, again except for regulatory lag, ratepayers are responsible for all of the utility's prudently incurred costs and for providing the shareholders with a reasonable return on their investment. If, at the time of the next rate case, costs, including the cost of capital, have risen, ratepayers absorb the future increases. As a trade-off, if, through greater efficiency or other factors, the utility is earning above the allowed rate of return, it will not be permitted to continue "overearning" when rates are next established. In short, risk and reward are aligned.

While incentive rate plans remove the traditional limits on a utility's profits, on the theory that the plans can be designed so that the benefits of the resulting productivity improvements will flow to both ratepayers and shareholders, they do not require a change in the relationship between risk and reward. For example, CMP's 1995 ARP was a model of symmetry, since it provided that above or below a specified "dead band," which was equal on the upside and the downside, the ratepayers and shareholders would divide the benefits of "overearning" and the costs of "underearning." Indeed, this symmetry has been a feature of all of the incentive plans adopted by the Commission, including the plan adopted for the New England Telephone and Telegraph Company (now Verizon). While that plan does not allow ratepayers to benefit from earnings above the established return on equity, it also does not impose any cost on them if the company falls short of that mark.

My support for symmetry is not such that I would suggest that there can never be other advantages for ratepayers that warrant deviating from the notion that over and underearning should be treated identically. In its Order, the Commission invokes two features of ARP 2000 as justification for the deviation. These are the "relatively high" productivity offsets and the strengthened service quality standards.

In fairness, if the productivity offsets are unusually high and/or the service quality standards are especially stringent, it can be argued that the plan does fairly allocate risks and rewards, even if not in a symmetrical way. To be more specific, productivity offsets and service quality standards could be set at levels that make it more likely that a utility will underearn than overearn. In that situation, it might well be fair for the utility, confronted with a higher probability of underearning, to be entitled to have ratepayers share some of the costs of underearning while the company retains all of the benefits of overearning. The question, however, is whether the case has been persuasively made here that the service quality standards and/or the productivity offsets are disproportionately favorable to ratepayers.

Any suggestion that in agreeing to the Stipulation, CMP made special concessions in the area of service quality conflicts with our statement in the order approving the Energy East merger that we expected the service quality standards of the Maine entity to be closer to those of its New York counterpart.

> We … put CMP on notice that we expect to closely examine service quality standards in the ARP 2000 proceeding. Given the risks involved in this merger, we will likely strengthen the standards relative to those in the existing ARP. We note that the standards in NYSEG's current rate plan are considerably more stringent than CMP's, and we expect to consider whether moving to, or beyond, the NYSEG level would be appropriate.

CMP Group, Inc., et. al., Request for Approval of Reorganization and of Affiliated Interest Transactions, Docket No. 99-411, Order (Jan. 4, 2000), at 25. In short, more stringent service quality standards were in effect part of our merger approval, and while the standards in the Stipulation are stronger than those in the 1995 ARP, they actually fall short of those in the NYSEG rate plan. As a result, I am hard pressed to see that they justify the asymmetrical treatment of earnings sharing.

A stronger case for asymmetry can be made based on the productivity offsets, for, as pointed out in the Order, the offsets in the Stipulation significantly exceed those in the 1995 ARP as well as those initially proposed by CMP for ARP 2000.[10] It is difficult to know, however, how much weight should be given to the 1995 comparison for two reasons. First, ARP 2000, unlike its predecessor, comes on the heels of a merger which is expected to produce savings from the synergistic effects of combining the companies. Second, our economy as a whole has become more productive, and it is reasonable to expect that some of that has rubbed off on electric utilities. Thus, while the favorable comparison with the earlier ARP is certainly good news for ratepayers, it does not necessarily warrant the conclusion that they have received some special benefit.

With respect to the argument that the stipulated offsets are substantially above those initially proposed by CMP, an attempt to quantify the benefit to ratepayers may prove helpful. Starting from the premise that vigorous negotiations might have produced offsets midway between those proposed by the Company and those recommended by the Examiners, the offsets in the Stipulation are indeed somewhat higher than would result from my hypothetical compromise. For the average residential ratepayer (one who uses about 450 kWh per month), however, the financial benefit of the stipulated offsets, when compared to my hypothetical compromise offsets, is only $18.05 over the 7-year life of ARP 2000, with most of that coming in the last three years. For me, that does not warrant the disparate treatment of earnings sharing.[11]

For those inclined to the view that the Company moved a long way on the offsets, it bears remembering that it received a significant benefit not found in prior plans and initially opposed by other parties, namely, a 7-year plan. As a result, if, as it apparently hopes, the Company is able to exceed the assumed productivity savings, it will have a lengthier period during which the shareholders will be the exclusive beneficiaries of its greater efficiency.

None of this is intended to diminish the potential advantages to the ratepayers of ARP 2000. As explained earlier, because of my belief in the notion that he who reaps the rewards should assume the risks, I think symmetrical treatment of underearning and overearning should be viewed as the norm from which we should deviate only upon a clear showing that ratepayers are receiving some special benefits in return. My position is simply that the requisite showing has not been made in this case, notwithstanding the existence of some admittedly attractive features of ARP 2000.

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[10] I offer no view on whether those are the most appropriate criteria for assessing the offsets, but since they are relied upon in the Order, I address them in my dissent.

[11] Cognizant of the old saw that if tortured enough, statistics can be made to confess to anything, I fully concede that determining what constitutes a fair comparison in this instance is a subjective judgment. If, contrary to my view, one believes that the appropriate comparison is between CMP's proposed offsets and those in the Stipulation, the amount saved by my average residential ratepayer is a more substantial $75.64 over the 7-year period.

Finally, I have a practical concern with ARP 2000's disparate treatment of earnings sharing. While any earnings sharing provisions, whether symmetrical or not, may create an incentive to time revenues and expenses to maximize ratepayer contributions, ARP 2000 creates a particularly strong incentive to dump into the same year all expenses over which the Company has some discretion as to when they are "incurred." By driving earnings in one year down to the level in which ratepayer sharing is triggered, the Company can secure an additional contribution from ratepayers in the form of higher rates, knowing there will be no corresponding decrease if, as might be expected, the ensuing year or years are especially profitable. Since the Company is likely to incur merger costs needed to achieve long-term synergies and to have considerable flexibility as to when those costs are incurred, the potential for timing decisions unfriendly to ratepayers seems unusually great. With its approval of ARP 2000, the Commission has an obligation to be especially alert to such conduct.

My dissent does not mean that I could not ultimately vote to approve ARP 2000 if further proceedings clearly demonstrated special benefits for ratepayers to compensate for the disparate treatment of over and underearning. Similarly, I would be favorably disposed to a revised ARP 2000 that did not contain the disparity to which I object.

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Civil Procedure, Rule 73, et seq.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.

APPENDIX A

On September 30, 1999, CMP filed a Request for Approval of an Alternative Rate Plan (ARP 2000). The Company's filing consisted of the direct testimonies of Dr. Jeffrey Makholm, Dr. Kenneth Gordon and Curtis Call/Robert Rude.

Due to the press of other business before the Commission, primarily related to electric restructuring and CMP's merger with Energy East, no action was taken on the Company's filing until March 10, 2000. At such time, the Commission issued a Notice of Proceeding which provided interested persons with an opportunity to intervene. Petitions to intervene were filed by Bangor Gas Company (Bangor Gas), the Office of the Public Advocate (OPA), Maine Public Service Company (MPS) and the Industrial Energy Consumers Group (IECG). In its petition, MPS indicated that it did not wish to present argument or evidence, but rather desire limited party status so that it could receive all filings in order to monitor the case. CMP indicated that it did not object to MPS's petition for limited intervenor status.

At the case conference held on March 31, 2000, the Independent Energy Producers of Maine (IEPM) orally made a late-filed petition to intervene in the case. There being no objection, the petitions of the OPA, the IECG, the IEPM and MPS were granted. At the case conference, CMP indicated that it had concerns about Bangor Gas's interest in this case and hence its right to intervene. Since a representative from Bangor Gas was not present, the Examiner asked counsel for CMP to discuss this matter with Bangor Gas and report back to the Examiner. In a letter dated April 4, 2000, CMP reported that pursuant to a conversation with counsel for Bangor Gas, Bangor Gas wished to be on the service list so it could follow the case but did not wish full party status. CMP indicated that it did not object to this status. Bangor Gas's limited petition for intervention was also granted.

Technical conferences on the Company's case were held on May 5, 2000, May 12, 2000 and May 17, 2000. The May 12th conference was a follow-up conference concerning Dr. Makholm's productivity study and was held at Dr. Makholm's office in Cambridge, Massachusetts so that Dr. Makholm could walk the parties and the Advisory Staff through his productivity model.

The Office of the Public Advocate filed its direct case on May 19, 2000 which consisted of the joint pre-filed testimony of Neil Talbot and Ronald Norton (Talbot/Norton) as well as the testimonies of Paul Chernick and Barbara Alexander. Technical conferences on the OPA's direct case were held on June 15, 2000 and June 19, 2000.

On June 22, 2000, the Company filed its rebuttal to the OPA's case. At the same time, the Commission's Advisory Staff filed its independent Bench Analysis in this matter. A technical conference on these filings was held on July 25, 2000.

A series of settlement conferences were held beginning on July 26, 2000. Written or oral notice was provided to all interested parties of these conferences. By agreement of the parties, the Advisory Staff was present and participated in all such conferences. While negotiations were ongoing, surrebuttal testimony and comments on the Bench Analysis were filed by both the OPA and the Company on August 10, 2000.

On September 7, 2000, the Commission received a Stipulation entered into between the Company and the OPA. A procedural order was issued on that date which allowed non-signing parties with an opportunity to file objections and to be heard. Written objections were filed by the IEPM and the IECG. A hearing on the Stipulation was held on September 13, 2000. At such time, Dr. Richard Silkman testified on behalf of the IECG in opposition to the Stipulation. In addition, at such time, the pre-filed testimonies of the parties, the Advisory Staff's Bench Analysis and the transcripts of the technical conferences referenced above were admitted into the record.